Supreme Court of the United States

OCTOBER TERM, 1937

No. 28

STATE OF TEXAS AND J. C. CLOPTON AND BULLOCK HYDE, RECEIVERS, ETC.,

Petitioners,

vs.

DAVID DONOGHUE, TRUSTEE OF TRINITY REFINING COMPANY, DEBTOR.

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

Supplemental Brief of David Donoghue, Trustee, under Order to Liquidate.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

DAVID DONOGHUE, Trustee, appointed under date of October 14, 1937, pursuant to an order to liquidate entered under date of September 24, 1937, with respect shows:

STATEMENT

The statements found in the briefs of petitioners and former respondent in this cause in the main set out the nature of the controversy. However, it is desired to emphasize two factors, which this respondent believes have an important bearing on the issues in controversy:

(1) The alleged illegal oil was in the actual possession of Trinity Refining Company, Debtor, at the time of the filing of its petition for corporate reorganization under the provisions of Section 77B of the Bankruptcy Act. The Trustee then appointed took possession of the oil and it has been continuously in the possession of the Trustee since that time.

(2) On the 24th day of September, 1937, upon motion of H. U. Everett, D. K. Hutchcraft and Howard Hall, Secured Creditors Committee, Trinity Refining Company, the Honorable District Court for the Northern District of Texas at Fort Worth, upon hearing, found that no proper plan for reorganizing the corporation had been accepted within the requisite period of time; that the corporation was insolvent; and ordered the estate of the debtor corporation liquidated by directing the Trustee to liquidate the estate in pursuance of the provisions of Section 77B (c) (8) and Section 77B (k) of the Bankruptcy Act of the United States as amended; that the case

be referred to a Referee and that a Trustee be appointed at a meeting of creditors to be called for that purpose in conformance with Section 44 of the Bankruptcy Act.

On the 14th day of October, 1937, at a meeting of creditors, called by the Referee to whom the matter was referred, a Trustee was appointed, in conformance with Section 44 of the Bankruptcy Act, the Honorable David Donoghue, this respondent, being so appointed, who thereafter qualified and who has filed in this cause his motion suggesting to this Court his appointment as Trustee under the order of liquidation aforesaid in the place and stead of the former respondent in this cause.

CONTENTIONS OF PETITIONERS

Petitioners in their brief make their argument under seven different points, which all may be reduced to the following propositions, viz:

(1) That Article 6066a of the Revised Statutes of 1925 of Texas is a lawful exercise of the police power of the State of Texas and under the terms of that article the mere circumstance of the overproduction of oil automatically results in a forfeiture with complete divestment of title out of the owner of the lease into the State of Texas; that, accordingly, title to the oil here in controversy passed to the State of Texas at the time such oil (allegedly) was

produced in violation of the rules of the Railroad Commission of Texas.

(2) That the District Court and the Circuit Court erred in declining to grant permission to the State of Texas to take proceedings for the confiscation of alleged illegal oil in a Texas State court of competent jurisdiction seeking confiscation of such oil, since the State of Texas acquired title to such oil prior to the filing of the petition under 77B, and since the claim of the State of Texas is unenforceable in the Bankruptcy Court.

CONTENTIONS OF THIS RESPONDENT

This respondent hereby adopts for all purposes the brief heretofore filed by the former respondent. However, it is desired to supplement the authorities filed in the former brief in that it is this respondent's opinion that the Honorable Trial Judge properly refused the State of Texas permission to proceed in the State courts with reference to the allegedly illegal oil and that the validity of the order of refusal is sustained by the following propositions:

I.

(1) Inasmuch as the oil in controversy was admittedly in the actual possession of the debtor at the time of the filing of the petition under Section 77B it follows that such right of possession was

immediately vested in the Trustee, and the Bankruptcy Court having taken possession of such property through its officer, the Trustee, thereby acquired such jurisdiction of the oil in question as to render the Bankruptcy Court fully competent to hear and determine all questions of title, possession and control of such oil.

(2) Since no judgment of forfeiture had been obtained by the State of Texas as against the oil in question at the time of the filing of the voluntary petition under 77B, and no such judgment has as yet been obtained by the State, full title to the oil in controversy was vested in the debtor at the time such petition was filed, and thereupon passed to the Trustee, who at this time retains full title, to the exclusion of any element of title in the State of Texas.

(3) Inasmuch as the Trustee in bankruptcy has both title and possession to the oil in question, any claim of the State of Texas in or to such oil, can only be asserted in the proceedings pending in bankruptcy.

(4) The claim asserted by the State of Texas against the oil is an attempt to assert a penalty and since such a claim is not cognizable in bankruptcy, the oil in controversy remains an asset in bankruptcy, subject to distribution to those creditors having provable claims under the provisions of the Bankruptcy Act.

(5) Upon the entry of an order to liquidate the estate of a debtor under Section 77B (c) (8) and 77B (k) of the Bankruptcy Act, the proceeding becomes comparable to general bankruptcy and is one for the primary benefit of the creditors of the debtor.

II.

PROPOSITION NO. 1 RESTATED

Inasmuch as the oil in controversy was admittedly in the actual possession of the debtor at the time of filing of the petition under 77B it follows that such right of possession was immediately vested in the Trustee, and the Bankruptcy Court having taken possession of such property through its officer, the Trustee, thereby acquired such jurisdiction of the oil in question as to render the Bankruptcy Court fully competent to hear and determine all questions of title, possession and control of such oil.

STATEMENT, AUTHORITIES AND ARGUMENT

Statement

It is uncontroverted that the oil in question, at the time the petition under Section 77B was filed, was in the actual possession of debtor, and is now in the possession of the Trustee appointed in the

proceedings in bankruptcy. (*Petitioner's Brief, pages 3, 4 & 5).*

Authorities

Baldwin, Ex Parte, 291 U. S. 610, 615, 54 S. Ct. 551, 78 L. Ed. 1020;
Board of Trade vs. Johnson, 264 U. S. 1, 11, 44 S. Ct. 232, 68 L. Ed. 533;
Herbert vs. Crawford, 228 U. S. 204, 205, 33 S. Ct. 484, 57 L. Ed. 800;
Isaacs vs. Hobbs Tire & Timber Co., 282 U. S. 734, 737, 738, 51 S. Ct. 270, 75 L. Ed. 645.
Murphy vs. Hofmann, 211 U. S. 562, 568, 569, 28 S. Ct. 141, 53 L. Ed. 327.
Wabash Refining Co. vs. Adelbert College, 208 U. S. 38, 54, 28 S. Ct. 182, 52 L. Ed. 379.

Argument

It was early established by this Court that a Federal District Court sitting in bankruptcy not only possesses the power directly granted by the Bankruptcy Act, but in addition possesses such necessary equitable powers as may be necessary to carry into effect the provisions of that Act. As a corollary of that rule it has long been recognized that when a Bankruptcy Court acquires possession of property through its officers it thereby obtains such jurisdiction over the property as to render it competent to pass on all questions of title, possession and control. This proposition was established in

1909 by this Court in an opinion written by Mr. Justice Moody, who said:

> "But where the property in dispute is in the actual possession of the court of bankruptcy, there comes into play another principle, not peculiar to courts of bankruptcy, but applicable to all courts, Federal or state. Where a court of competent jurisdiction has taken property into its possession, through its officers, the property is thereby withdrawn from the jurisdiction of all other courts. *The court, having possession of the property, has an ancillary jurisdiction to hear and determine all questions respecting the title, possession, or control of the property.*" (Italics ours). *Murphy vs. Hofman*, 211 U. S. 562, 568, 569, 28 S. Ct. 141, 53 L. Ed. 327.

The same proposition was affirmed by an opinion of this Court by Mr. Justice Roberts, who said:

> "Upon adjudication, title to the bankrupt's property rests in the trustee with actual or constructive possession and is placed in the custody of the bankruptcy court . . . It follows that the bankruptcy court had exclusive jurisdiction to deal with the property of the bankruptcy estate . . . When this jurisdiction has attached the court's jurisdiction cannot be affected by actions brought in other courts . . . This is by an application of the well recognized rule that when a court of competent jurisdiction takes possession of property through its officers, this withdraws the property from jurisdiction of all

other courts, which 'though of concurrent jurisdiction 'may not disturb that possession; *and that the court originally acquiring jurisdiction is competent to hear and determine all questions respecting title, possession and control of the property'.*" (Italics ours). *Isaacs vs. Hobbs Tire and Timber Company*, 282 U. S. 734, 737, 738, 51 S. Ct., 270, 75 L. Ed. 645.

Other opinions by this court to the same effect are as follows: *Board of Trade vs. Johnson*, 264 U. S. 1, 11, 44 S. Ct., 232, 68 L. Ed. 533; *Ex parte Baldwin*, 291 U. S. 610, 615, 54 S. Ct., 551, 78 L. Ed. 1020; *Herbert vs. Crawford*, 228 U. S. 204, 205, 33 S. Ct. 484, 57 L. Ed. 800; *Wabash Refining Company vs. Adelbert College*, 208 U. S. 38, 54, 28 S. Ct., 182, 52 L. Ed. 379.

The order of the trial court denying the motion of petitioners, that the oil in controversy be released from the bankruptcy proceedings for the purpose of enabling the State of Texas to proceed under Article 6066a, amounted to a judgment affirming the jurisdiction of the Bankruptcy Court to hear and determine any question of title to the oil. Such position is supported by the above authorities.

III.

PROPOSITION NO. 2 RESTATED

Since no judgment of forfeiture had been obtained by the State of Texas as against the oil in question at the time of the filing of the voluntary petition under 77B, and no such judgment has as yet been obtained by the State, full title to the oil in controversy remained vested in the debtor until the date such petition was filed, and thereupon passed to the Trustee, who at this time retains full title to the exclusion of any element of title in the State of Texas.

STATEMENT, AUTHORITIES AND ARGUMENT

Statement

On page 20 of petitioners' brief it is argued that unlawful oil and unlawful products of oil become forfeit oil immediately upon being produced in violation of the law, and that as a result title is automatically divested out of the owner of the lease at the time of overproduction, and vested in the State of Texas.

It is uncontroverted that the State of Texas has not obtained a judgment of forfeiture in accordance with the provisions of Article 6066a, Section

10, Revised Civil Statutes of Texas (Acts 1935, 44th Leg., p. 624, Ch. 246), and that as a matter of fact, no proceedings have ever been instituted in the State Courts of Texas for the purpose of obtaining such a forfeiture. *(Petitioners' Brief, p. 2).*

Authorities

Article 6066a, Sec. 10, (a), (b) & (c), R. C. S.;
Berry vs. S. Maris, 76 N. J. L. 301;
Clark vs. Protection Insurance Co., 1 Story, 134 Fed. Cas. 2832;
Craig vs. Kline, 96 Pa. St. 399, 3 Am. Rep. 636;
Darsp vs. People, 51 Ill. 386, 2 Am. R. 301;
Heidretter vs. Elizabeth Oil Cloth Co., 6 Fed. 141;
The Kate Heron, 6 Sawy. 109, 111 Fed. Cas. 7619;
Matlow vs. Missouri, 295 U. S. 97, 79 L. Ed. 1327;
Schenck vs. Peay, 21 Fed. Cas. 683;
The Sterling (Cir. Ct., 5th Cir. 1933), 65 F. (2d) 439;
Strong vs. United States, (Cir. Ct. of App., 1st Cir.), 46 F. (2d) 257, 259;
Terrozas vs. Donohue, 227 S. W. 206, Aff. (1925), 275 S. W. 396; 115 Tex. 146;
United States vs. 1960 Bags of Coffee, 12 U. S. (8 Cranch) 398, 3 L. Ed. 603;
United States vs. One Hundred Barrels, 2 Abb. (U. S.) 314, 320, S. C. Fed. Cas. 15948;

United States vs. One Hundred Barrels Distilled Spirits, 14 Wall. 44, 20 L. Ed. 815;
United States vs. 66 Barrels of Whiskey, 25 F. Cas. No. 15095, 1 Abb. 93;
United States vs. Grundy, 3 Cranch (U. S.) 337, 2 L. Ed. 459;
United States vs. Mars, 12 U. S. (8 Cranch) 417, 3 L. Ed. 609;
United States vs. Stowell, 133 U. S. 1, 17, 33 L. Ed. 559;
United States vs. Three Hundred, Etc., 28 Fed. Cas. 124.

Argument

This respondent cannot agree with petitioners' arguments concerning title. At common law a forfeiture does not operate until, by proper judgment in an action instituted for that purpose, the rights of the sovereignty have been established. *United States vs. Grundy*, 3 Cranch (U. S.) 337, 2 L. Ed. 459; *United States vs. 66 Barrels of Whiskey*, 25 F. Cas. No. 15095, 1 Abb. 93; *Strong vs. United States*, (Cir. Ct. of App. 1st Cir.) 46 F. (2d) 257, 259.

When a forfeiture is declared by statute the common law rule as to the vesting of title may be dispensed with, subject to certain limitations, the chief of which is that the owner must be given notice, and the opportunity to defend, enforce and protect his rights before a court of competent jurisdiction or the due process clause of the constitution is violated.

Craig vs. Kline, 96 Pa. St. 399, 3 Am. Rep. 636; *Darsp vs. People*, 51 Ill. 386, 2 Am. R. 301; *Berry vs. S. Maris*, 76 N. J. L. 301; *Terrozas vs. Donohue*, 227 S. W. 206, Aff. (1925), 275 S. W. 396, 115 Tex. 146.

On the basis of the limitation referred to, this court, during the past one hundred years, has established definite rules concerning the time when title passes under various types of forfeiture statutes, as follows:

(a) If the act in question is absolute, that is, if it unqualifiedly provides that the commission of the illegal act thereby forfeits the property involved, the power of the sovereign to subject the property to forfeiture as of the time of the illegal act, is recognized. However, the mere commission of the illegal act does not automatically divest the owner of title. No element of title is vested in the sovereign until judgment of condemnation or of forfeiture is entered whereupon the title obtained by the sovereign will then be deemed to relate back and take effect as of the date of the illegal act.

For example, in the case of *United States vs. Stowell*, 133 U. S. 1, 17, 33 L. Ed. 559, this court said:

> "By the settled doctrine of this court whenever a statute enacts that upon the commission of a certain act specific property used in or connected with that act shall be forfeited; the for-

feiture takes effect immediately upon the commission of the act; the right to the property then vests in the United States, *although their title is not perfected until judicial condemnation;* the forfeiture constitutes a statutory transfer of the right to the United States at the time the offense is committed, and the condemnation, when obtained, relates back to that time, and avoids all intermediate sales and alienations, even to purchasers in good faith." (Italics ours).

Other cases to the same effect are: *United States vs. 1960 Bags of Coffee*, 12 U. S. (8 Cranch) 398, 3 L. Ed. 603; *United States vs. 100 Barrels Distilled Spirits*, 14 Wall. 44, 20 L. Ed. 815; *Matlow vs. Missouri*, 295 U. S. 97, 79 L. Ed. 1327; *The Sterling* (Cir. Ct. 5th Cir. 1933) 65 F. (2d) 439; *Strong vs. United States*, (Cir. Ct. 1st Cir. 1931), 46 F. (2d) 257, 261; *Heidretter vs. Elizabeth Oil Cloth Co.*, 6 Fed. 141; *Clark vs. Protection Insurance Co.*, 1 Story 134, Fed. Cas. 2832; *United States vs. Three Hundred, Etc.*, 28 Fed. Cas. 124.

(b) If the statute in question fails to establish the time when the sovereign's rights shall take effect or if the statute is so written as to admit of doubt as to the effective time, then the common law rule will be followed and title will be deemed vested in the sovereign as of the date of the judgment of condemnation or of forfeiture.

For example, in the case of *United States vs. 1960*

Bags of Coffee, 12 U. S. (8 Cranch), 398, 405, 3 L. Ed. 602, this court said:

> "If the phraseology were such as, in the opinion of the majority of the court, to admit of doubt, it would then be proper to resort to analogy and the doctrine of forfeiture at common law, to assist the mind in coming to a conclusion."

Other cases to the same effect are: *United States vs. Mars*, 12 U. S. (8 Cranch) 417, 3 L. Ed. 609; *United States vs. One Hundred Barrels*, 2 Abb. (U. S.) 314, 320, S. C. Fed Cas. 15948; *The Kate Heron*, 6 Sawy. 109, 111, Fed. Cas. 7619; *Schenck vs. Peay*, 21 Fed. Cas. 683.

In the instant case, the State of Texas has not obtained a judgment of forfeiture and, accordingly, under either rule, title to the oil in controversy remains vested in Trinity Refining Company, or its lawful representatives. As a matter of fact, it seems clear that Article 6066a (10) Revised Statutes of 1925 of Texas does not provide for an absolute forfeiture, but instead specifically adopts the common law rule, with title vesting in the State of Texas, only following judgment of forfeiture and sale as under ordinary executions. This position is substantiated by the following provisions of the statute in question:

"Sec. 10, (a). All unlawful oil and unlawful products, regardless of the date of production or manufacture thereof, are hereby declared to be a nuisance

and shall be forfeited to the State as hereinafter provided."

"(b). When the Attorney General is advised from any source of the presence and existence of unlawful oil and/or unlawful products, it shall be his duty to institute a suit in rem against such unlawful oil and/or unlawful product and against all persons owning, claiming or in possession thereof."

"(c) . . . If, upon the trial of such suit the oil or product in controversy is found to be unlawful oil or unlawful products, then the court trying said cause *shall render judgment forfeiting the same to the State of Texas and authorizing the issuance of an order of sale directed to the sheriff or any constable of the County where the oil or products are located commanding such officer to seize and sell said property in the same manner as personal property is sold under execution.*" (Italics ours).

In view of the foregoing it is respectfully submitted that title to the oil in question has never vested in the State of Texas under the provisions of Article 6066a (10) of the Revised Statutes of 1925 of Texas, and that by the very language of the statute quoted above (Section (c), no forfeiture occurs until so decreed by a court of competent jurisdiction and no title passes until seizure and sale by the sheriff as under execution.

IV.

PROPOSITIONS NOS. 3 AND 4 RESTATED

3. Inasmuch as the Trustee in bankruptcy has both title and possession to the oil in question, any claim of the State of Texas in or to such oil, can only be asserted in the proceedings pending in bankruptcy.

4. The claim asserted by the State of Texas against the oil is an attempt to assert a penalty, and since such a claim is not cognizable in bankruptcy, the oil in controversy remains an asset in bankruptcy, subject to distribution to those creditors having provable claims under the provisions of the Bankruptcy Act.

STATEMENT, AUTHORITIES AND ARGUMENT

Statement

While the position is not clearly taken in any particular instance which may be quoted, throughout petitioners' brief it is apparent that petitioner is of the opinion that it should be entitled to the extraordinary relief for which it prays, largely by reason of the fact that it is a sovereign State, and that the usual provisions of the Bankruptcy Act should not apply since their enforcement would prevent the State of Texas from obtaining the full pen-

alties otherwise possible in a proceeding in the State Court.

Authorities

The Antelope, 10 Wheat, 66;
Commonwealth of Penn. vs. York Silk Mfg. Co., (Cir. Ct., 3rd Cir. 1911), 192 Fed. 81;
International Shoe Co. vs. Pinkus, 278 U. S. 261, 265, 73 L. Ed. 318, 320, 49 S. Ct. 108;
Matter of Abramson and Fichhandler, (Cir. Ct. 2nd Cir. 1914), 210 Fed. 878;
Matter of Semon, (U. S. Dist. Ct. Conn. 1935), 11 F. Supp. 18;
New York vs. Irving Trust Co., 288 U. S. 329, 333, 77 L. Ed. 815;
New York vs. Jersawit, (1923), 263 U. S. 493, 68 L. Ed. 405;
United States vs. Birmingham Trust Co., (Cir. Ct. 5th Cir. 1919), 258 Fed. 562;
Wisconsin vs. Pelican, 127 U. S. 265.

Argument

Mr. Justice McReynolds delivered the opinion of this Court in the case of *New York vs. Irving Trust Co.*, 288 U. S. 329, 333, 77 L. Ed. 815. In that opinion it was held that a sovereign State, as any other party, is bound by the Bankruptcy Act. In that case the State of New York failed to file its claim for taxes within the time fixed by the Referee. As a result its claim was disallowed. On appeal the State

of New York took the position that a requirement that a state file its claim within a specified time is an unconstitutional infringement of the State's sovereignty. Mr. Justice McReynolds in the opinion said:

> "The Federal government possesses supreme power in respect to bankruptcies. *International Shoe Co. vs. Pinkus*, 278 U. S. 261, 265, 73 L. Ed. 318, 320, 49 S. Ct. 108. If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

By virtue of the terms and provisions of the Bankruptcy Act, assets and property of which the Trustee has title and possession may only be administered and distributed in conformance with the provisions of the Act itself. The State of Texas has not brought itself within any provision of the Bankruptcy Act entitling it to the relief it seeks. The sole authority advanced in support of petitioners' position is a State statute, which petitioner admits to be one of penalty and forfeiture. The statute in question does not eliminate even admittedly illegal oil from commerce, but has for its purpose a monetary penalty in favor of the State. Should the State be permitted to secure a forfeiture in a State court, in accordance with Article 6066a of the Revised Statutes of Texas and under petitioners customary procedure the oil

in controversy would be sold to the highest bidder, the State would pocket the money and in consideration of the purchase price would legitimatize the oil by granting the buyer tenders enabling the buyer to freely move the oil in intra-state commerce. Even though the State is here ostensibly claiming the oil itself such claim cannot conceivably constitute a provable claim in bankruptcy as defined in Section 63. On the contrary the claim falls definitely within that class denied by the terms of Section 57 (j) of the Bankruptcy Act, which provides:

> "Debts owing to the United States, a state, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby, and such interest as may have accrued thereon according to law."

Under this Section Federal courts, sitting in bankruptcy, have not hesitated to disallow claims of the Federal government for penalties as well as those of the respective states. *United States vs. Birmingham Trust Company*, (Cir. Ct. 5th Cir. 1919), 258 Fed. 562; *Matter of Semon*, (U. S. Dist. Ct. Conn. 1935) 11 F. Supp. 18; *New York vs. Jersawit*, (1923) 263 U. S. 493, 68 L. Ed. 405; *Commonwealth of Penn. vs. York Silk Mfg. Co.*, (Cir. Ct. 3rd Cir. 1911) 192 Fed. 81; *Matter of Abramson and Fichhandler*, (Cir. Ct. 2nd Cir. 1914), 210 Fed. 878.

Although petitioner admits in its brief that it is seeking to enforce a penalty it may perhaps be argued that the State of Texas is not seeking to establish a claim in bankruptcy and that Section 57 (j) does not for that reason apply. If this be true, then the State of Texas is attempting to accomplish indirectly what it cannot do directly, and its efforts for that reason should fail. Certainly to order the Trustee to turn over to petitioner valuable assets, title and possession to which is held by the Trustee, for the purpose of enabling the State to enforce a penalty does as much violence to the letter and spirit of Section 57 (j) as would the action of a Bankruptcy Court in allowing a claim for penalties and directing payment by the Trustee before all lien and administration claims.

Not only is the position of the State of Texas in direct conflict with Section 57 (j) of the Bankruptcy Act, but it also violates the proposition first stated by Chief Justice Marshall in *The Antelope*, 10 Wheat. 66:

> "The Court of another country cannot execute the penalty laws of another."

In the case of *Wisconsin vs. Pelican*, 127 U. S. 265, this Court directly held that the Federal courts have no power to execute the penal laws of the individual states.

V.

PROPOSITION NO. 5 RESTATED

Upon the entry of an order to liquidate the estate of a debtor under Section 77B (c) (8) and 77B (k) of the Bankruptcy Act, the proceeding becomes comparable to general bankruptcy and is one for the primary benefit of the creditors of the debtor.

STATEMENT, AUTHORITIES AND ARGUMENT

Statement

The proceeding in bankruptcy in this cause was initiated by a petition for reorganization of a corporation filed under the provisions of Section 77B of the Bankruptcy Act by Trinity Refining Company. A Trustee was appointed and the administration of the property and assets of the debtor carried on under the provisions of the Act. On September 24, 1937, an order was entered by the Honorable District Court for the Northern District of Texas at Fort Worth, upon hearing, in which the debtor was found to be insolvent and its estate and property directed to be liquidated under the provisions of Section 77B (c) (8) and 77B (k) of the Bankruptcy Act. In pursuance of that order the matter was referred to a Referee, a meeting of creditors was called under the provisions of Section 44, and a Trustee was appointed by the creditors as

therein provided on the 14th day of October, A. D., 1937.

Authorities

Bankruptcy Act of 1898, as amended, Sections 44; 57 (j); 64; 77B; 77B (c) (8); and 77B (k);
In re: *Chez Marianne,* 15 F. Sup. 327.

Argument

Section 77B of the Bankruptcy Act (11 U. S. C. A. 207) was enacted primarily for the benefit of distressed corporations in that it seeks to give a distressed debtor corporation the opportunity to reorganize its capital structure and thus preserve the going concern value of its assets. Creditors are protected in that they are given a voice in the plan of reorganization and the whole procedure takes place under the direction and control of Federal courts, sitting in bankruptcy.

Section 77B (c) (8) of the Bankruptcy Act makes provision, however, for the liquidation of a debtor corporation when the possibility of a reorganization for its benefit no longer exists. By the terms of this section the court may direct a liquidation of assets and property of the debtor concern provided it is found to be insolvent and the possibility of equity or benefit to the debtor corporation no longer exists.

When an order for liquidation is entered the proceeding is no longer one for the benefit of the debtor corporation, but the liquidation as directed is for the primary benefit of its creditors. Section 77B (k) provides the manner of liquidation under Section 77B and, upon the finding of insolvency required by Section 77B (k) (8), a Trustee is to be appointed as provided in Section 44. Certain sections of the Act theretofore inapplicable become applicable upon liquidation, and the proceeding thereafter becomes one primarily and wholly for the liquidation and distribution of the assets and property of the debtor corporation to its creditors in a manner comparable to general bankruptcy.

The effect of an order to liquidate in a proceeding under 77B is discussed in an opinion by Judge Knox, of the Southern District of New York, in the case of *In re*: *Chez Marianne*, 15 F. Supp. 327, in which he said:

> "When a proceeding instituted under Section 77B (11 U. S. C. A. 207) turns out to have been abortive, and is relegated to the practice long familiar in ordinary bankruptcy, the theory of creditor control of the estate becomes operative, and creditors, pursuance to Section 44 (11 U. S. C. A. 72), are entitled to choose the Trustee who will administer the assets."

It is thus apparent that this proceeding has become one for the liquidation of the assets and prop-

erty of the debtor corporation, Trinity Refining Company, and for the distribution of the proceeds from such liquidation to those creditors entitled to such distribution under the terms of the Bankruptcy Act, giving due regard to creditors holding liens and to the order of priority of payment provided by Section 64 of the Bankruptcy Act. The State of Texas has not in its asserted claim brought itself within any class of creditor or party entitled, under the terms of the Bankruptcy Act, to any distributive interest in the estate of debtor corporation. On the contrary the ulterior motive of petitioners is the attempt to obtain a monetary recovery by way of penalty and such a claim is not cognizable in bankruptcy. If petitioners should be allowed to obtain possession of the oil in controversy and should petitioners in the State Court obtain judgment of forfeiture, such judgment would result in the immediate sale of the illegal oil by the State to the highest bidder. The State would pocket the money and in consideration of the purchase price paid for the oil, the buyer, whoever he might be, would be granted tenders authorizing him to freely move the oil in question in intra-state commerce. Since this proceeding is now a creditors proceeding, such result would mean that the public at large would not be benefited by such recovery since the oil, although illegally produced, would eventually find its way into commerce; the debtor would not be penalized since it has been found to be insolvent and all of its assets

are to be distributed prorata to its creditors. The final result would be the unjust enrichment of the State of Texas at the expense of civil creditors, who had no part in the alleged unlawful act.

SUMMARY

It is respectfully submitted that the action taken by petitioners in the final analysis is either in the nature of an action in the Bankruptcy Court to try title or a prayer for the satisfaction of a claim. If the motion as made by petitioners in the trial court be considered one to try title to the oil involved, then the Bankruptcy Court had full authority to hear and determine such issue and under the authorities was correct in its implied holding that the Trustee held title to the oil in question.

If on the other hand the motion filed by the State of Texas in the trial court be considered as the request for the satisfaction of a claim, then the order denying the relief sought was properly entered as the judgment of the trial court for the reason that the character of claim asserted by the State of Texas is not one provable in bankruptcy by virtue of the provisions of Section 57 (j) of the Bankruptcy Act and for the further reason that granting such relief would mean the enforcement by the Federal Court, sitting in bankruptcy, of a penal law of the State of Texas.

WHEREFORE, premises considered, this respondent respectfully prays to this Court that the opinion of the Circuit Court of Appeals, which is reported in 88 Fed. (2d) 48, be in all things affirmed.

DAVID DONOGHUE, *Respondent*,

By R. W. Kellough
Attorney.

R. W. KELLOUGH, Tulsa, Oklahoma,
Attorney for Respondent.
H. T. MCGOWN,
H. L. LOGAN, JR.,
Fort Worth, Texas,
Of Counsel."

Proof of Service of Copy

I, R. W. Kellough, do by these presents certify that I did on the 16th day of October, 1937, serve a copy of the foregoing upon William McCraw, Attorney General of the State of Texas, and W. B. Harrell, Counsel for Respondent.

R. W. Kellough

R. W. KELLOUGH.

Subscribed and sworn to before me this the 16th day of October, 1937.

Margaret M. Fenelon

Notary Public in and for Tarrant County, Texas.

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No. 28

In the Supreme Court of the United States

October Term, 1937.

STATE OF TEXAS AND J. C. CLOPTON AND BULLOCK HYDE, RECEIVERS, ETC., *Petitioners,*

vs.

DAVID DONOGHUE, TRUSTEE OF TRINITY REFINING COMPANY, DEBTOR, *Respondent.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

Reply of Respondent to Supplemental and Reply Brief for the State of Texas.

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